FHP, Inc.
in Fountain Valley, California

Report No. 66-00-92-059

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Our audit of the FEHBP operations at FHP, Inc., in Fountain Valley, California, covered contract years 1987 through 1991. FHP provides member health benefits in Arizona, California, Guam, New Mexico, and Utah. We examined the plan's federal rate submissions and related documents along with rating documents and billings to other groups FHP serviced during those contract years to determine if the plan had offered either community rates or market price rates to the FEHBP in accordance with its contract and OPM regulations. We also looked at loadings (riders) to the FEHBP contract for those years to see if they were reasonable and equitable and reviewed enrollment statistics to verify their accuracy.

Our audit of the Arizona region covered contract years 1987 through 1991, while the audit for the other four regions encompassed contract years 1988 through 1991. We found that the plan provided discounted rates to numerous groups from 1987 through 1991. Since the plan did not give the FEHBP similar discounts, we determined that the FEHBP was entitled to retroactive rate adjustments totaling $17,753,593. This amount also included overcharges by the plan relating to its children's loadings, outpatient copay undercharges, and industry factors (adjustments a member group receives based on the specific industry environment of its subscribers). It should be noted that, in a previous audit of FHP, completed in 1987, we also cited the plan for improper rate adjustments that produced overcharges to the FEHBP.

Questioned Costs to FEHBP Total $17,753,593

Our audit revealed that defective community rating or pricing issues were prevalent across all FHP regions. The plan's use of unsupported demographic assumptions in developing rates for many non-FEHBP groups consistently produced discounted rates, and thus preferential treatment, for those groups. The pervasiveness of these practices is best illustrated in the following summary of findings by region.

Arizona: In its 1987 through 1989 rate submissions to OPM, the plan reported that it used either a traditional rating or a community-rating-by-class (CRC) rating methodology for establishing rates for its member groups in Arizona. Although the plan had established book rates (standard community rates), several groups were afforded rates below the book rate. In reviewing 1990 and 1991 rate submissions, we concluded no retroactive rate adjustments were warranted.

California: For the audit period 1988 through 1991, our review of the plan's rating methodology for groups in the California region showed that FHP used unsupported demographics to rate many of its groups. Using assumed data rather than actual, the plan was able to lower rates for some groups. We took particular exception to this use of arbitrary demographic statistics to legitimatize reduced rates, a practice indicative of DCR and DP.

Guam: Our review indicated that several groups were afforded discounted rates through FHP's use of unsupported favorable demographics in its rate calculations. We also found instances whereby the plan reduced a particular group's calculated CRC rates for no apparent reason.

New Mexico: We found many instances where selected groups received discounted premium rates from FHP. In addition, we noted a report issued by the New Mexico Department of Insurance for the period January 1, 1988 through June 30, 1990, that cited the plan for charging lower than state-filed community rates to many of its groups.

Utah: For the period 1988 through 1991, FHP departed from its established procedures of using actual demographics in favor of demographics predicated on the assumption that a group's average contract size would decrease as a result of the open season campaign. The use of these predictions resulted in lower rates for the groups involved. In the case of the region's largest group, FHP used an "area adjustment factor" as a means to lower the group's rates.

The plan did not agree with the merit of any of our findings. Our review of FHP's response to the draft report, as well as an in-depth analysis of our audit work papers, prompted us to refer certain audit issues, including DCR and DP issues, to our Office of Investigations and later to the Department of Justice (DOJ) for further scrutiny. In October of 1996, the U.S. Attorney's office for the District of Columbia reached a negotiated settlement with FHP in the amount of $12 million. (See also Appendix I on page 31 as well as pages 21-22 of the Investigative Activities section of this report.)

FHP, Inc. Agrees to $12 Million Settlement